

Considerations for Transfer of the UNDP/EU Guarantee Programs

Summary statistics, per the loan portfolio printouts by bank provided by UNDP to HAMAG, are as follows:

As of 31 March 2005	Small Crafts Guarantee Program	SME Guarantee Program	Combined Totals
Number of Active Loans	605	184	789
Original Amount of Active Loans	€2,781,577	€5,269,183	€8,050,760
Outstanding Portfolio	€1,435,345	€4,796,113	€6,249,458
Amount of Loans Past Due*	€253,149	€264,652	€517,801
% Portfolio Past Due	17.4%	5.5%	8.3%
Amount of Loans in Litigation or > 90 Days Past Due	Unavailable	Unavailable	€330,469

*In some cases this number was not available, so the >90 days number was used.

A full summary by bank of the information on the loan portfolios is attached.

As of 31 March 2005 the amount of funds in the banks from UNDP/EU was about €4,653,132 (US\$ deposits converted at \$1.28 = €1) plus €154,339 of earned interest. The amount pledged for guarantees is €3,151,354.

Going forward, the plan is for the loan guarantees for SMEs to be resumed, and all unpledged funds will be available to cover these loans. The SME loans are for up to the equivalent of €70,000, with the guarantee typically at 50%, but available up to 70%. The small crafts loan guarantee program, targeted to returning refugees, ended as of 30 November 2004 and will not be resumed. As these loans are paid out the guarantee funds will be available for SME guarantees.

In taking over the UNDP/EU guarantee programs HAMAG will be mindful of two overarching considerations that UNDP was trying to achieve in making these guarantees available in the Areas of Special State Concern:

- Assistance to small businesses in these regions – in other words, the maximum loan size, and location of the target businesses should not be broadened
- Development of a credit culture – the guarantees were not intended to be a grant program, and the guarantees were only to be used (funds offset) after pursuing the borrower and liquidating other collateral

In working with the banks in the future HAMAG needs to deal with two major issues:

- Creating a working relationship with the banks (and local LEDAs) to restart the volume of loans to small businesses in the areas of special state concern
- Ensuring that past due loans are collected

The chart above is important in light of the need to collect the past due loans. For all of the banks except Nova, the small crafts loans have higher past due amounts than the SME loans, and are as high as 23% of the total outstanding loan balance. The past due status of the SME loans is more manageable, at an average of 5.5% across the board (although over 11% for Nova Banka). Since the small crafts guarantee program is not being continued, only the collection problem needs to be addressed.

In meeting with each of the banks, the following information needs to be determined (for both the small crafts and SME loans):

- The agings of the past due loans (0-30-60-90 day status)
- The bank's usual problem loan followup procedure
- Actions being taken to collect particular problem loans
- A list of loans in litigation, and status of each litigation

Obtaining this information is important to understanding whether the bank really does have major issues with collection, or whether there are really only a few isolated problems.

The key to pursuing loan workouts is to constantly monitor the loans, and make sure that followup actions are being taken in a timely basis. For HAMAG, this means that it should have the bank regularly report in on its progress – on a weekly basis is not too frequently – so that the problem loans are worked down. This reporting can easily be done by providing electronic spreadsheets, sent in by e-mail: it is not necessary to have the information “certified” by the bank.

If a bank shows that it has pursued collection, has sold collateral (if any), and otherwise is not able to realize any more payments on a loan, it should be authorized to offset the amount of the guarantee. Coming to an immediate resolution as to which loans already fit this criteria, and authorizing the offset, would be a strong goodwill gesture at the start of the HAMAG-bank relationship.

A decision should also be made, after determining the real status of the loans, what a low cutoff number should be. In some cases the amount of monies still showing as owed on the list are minor, and may even represent accounting discrepancies. In these cases it is easier, and more cost-effective, to allow a bank to offset the guarantee amount than to continue to pursue collection. In keeping with the “credit culture” directive this should be a relatively low amount (e.g., €200 loan amount, of which €100 would be offset).

It should be noted that overall HAMAG does benefit from having the past due loans collected, both because the guarantee fund will not be depleted, and because the “credit culture” attitude will be preserved.

In the longer run, and ultimately more important than the workouts of existing problem loans, are the discussions concerning the future working relationship of HAMAG with the banks, and secondarily the local LEDAs, in facilitating credit for SMEs in these regions.

Based on the conversations held with some of the banks last January, the following information emerged:

- The fact that the guarantee funds are deposits in the bank is the major attraction of the program.
- The banks do find it difficult to make loans to the target clients in the target areas.

As matters stand, the banks do not have any particular incentive to look for new loan clients for the program, as the deposit funds are now maintained in the banks whether or not they are pledged. This means that HAMAG has leverage to encourage the banks to find appropriate loan clients. It also means that other banks would be interested in participating in the program.

In taking over the guarantee funds HAMAG is accepting UNDP’s challenge to facilitate lending to hard-to-serve clients in economically depressed areas, but this effectively is a part of HAMAG’s mandate anyway. The UNDP program is quite favorable to the bank, and as such there is concern that it will drive out conventional lending in the regions where the program is available. For these reasons it is important that the amounts, target beneficiaries, and geographic areas not be expanded.

I recommend that HAMAG develop an agreement with each bank, with performance targets and target dates for achievement of these performance targets. For instance, in cooperation with each bank, the goal will be set to approve at least X number of loans, for a value of €Y, within a Z month period. The performance period should be limited (my own preference would be 4 – 6 months) so that the bank does have enough time to act, but the timeframe is short enough such that the bank cannot delay in seeking out new clients and making new loans.

In the event the bank does not live up to the agreement (and HAMAG can be flexible in evaluating the bank’s performance and interest in the program at the end of the performance period) HAMAG can find another bank in the area that is interested in doing this kind of lending, and move the unpledged funds to that bank. While ordinarily it would be desirable to open the program to many banks and only deposit the guarantee funds when a loan is made, in this case the banks are more likely to be motivated by holding more deposits than needed for the guarantee. Giving the current participants the

opportunity perform, by making a certain number of loans within a given period of time, is likely to produce the greatest amount of credit for these sectors.

Note that the agreements with the banks may also include performance targets for pursuing the problem loans.

HAMAG also needs to work with the banks on developing streamlined approval procedures. The credit approval procedure described in the Transfer Agreement with UNDP is cumbersome, and should be adjusted on a bank by bank basis so that it is more efficient. New lending procedures do not need to be instituted immediately, but HAMAG should start giving thought to this, including asking the individual banks for their recommendations.

In addition to meeting with the banks, HAMAG needs to start meeting with the local LEDAs, to confirm their role in the lending procedure in the future, and to position them to assist new borrowers, and potential new borrowers, with planning as well as business and financial management. Note that the Transfer Agreement does call for the interest earned on the accounts to be available in part to the LEDAs for technical assistance.

UNDP/EU Gtee Funds		Figures in Euros €, unless shown in Column 1 as US\$									
Bank/Type of Loans	Location	# Active Loans	Orig Ln Amount	Avg Or'g Ln Amt	Outs'g Amount	Avg O/S Ln Amt	Past Due Due Amt	% Past Due	G'tee Amount	Loans > 90 days	% > 90 Days:
Pozeska Banka											
Small Crafts		146	584,005	4,000	253,689	1,738	60,498	23.8%	126,844	60,498	23.8%
SME Loans, few crafts		39	987,144	25,311	869,400	22,292	73,172	8.4%	467,187		
SME Loans		11	416,018	37,820	357,577	32,507	2,590	0.7%	203,868		
	Subtotal	50	1,403,162	28,063	1,226,977	24,540	75,762	6.2%	671,055	75,762	6.2%
Totals, Pozeska Banka		196	1,987,167	10,139	1,480,666	7,554	136,260	9.2%	797,899	136,260	9.2%
Nova Banka											
Small Crafts		156	758,777	4,864	327,029	2,096	30,848	9.4%	166,036	7,740	2.4%
SMEs		9	240,146	26,683	184,695	20,522	21,683	11.7%	97,662	21,683	11.7%
Totals, Nova Banka		165	998,919	6,054	511,724	3,101	52,531	10.3%	263,698	29,423	5.7%
Croatia Banka											
Small Crafts \$\$	Vinkovci	57	319,075	5,598	130,537	2,290	29,509	22.6%	65,268		
Small Crafts \$\$	Zupanja	24	122,732	5,114	37,546	1,564	8,389	22.3%	18,773		
Small Crafts \$\$	Osijek	30	113,306	3,777	46,049	1,535	3,739	8.1%	23,025		
	Subtotal	111	555,113	5,001	214,132	1,929	41,637	19.4%	107,066	20,964	9.8%
€Equivalent, at \$1.28 = €1		111	433,682	3,907	167,291	1,507	32,529	19.4%	83,645	16,378	9.8%
SME	Vinkovci	9	411,186	45,687	387,679	43,075	13,970	3.6%	179,644		
SME	Zupanja	3	170,000	56,667	164,510	54,837	0	0.0%	82,255		
SME	Osijek	11	285,000	25,909	248,352	22,577	10,256	4.1%	119,561		
SME	Zadar	64	1,734,600	27,103	1,635,957	25,562	99,028	6.1%	791,437		
	Subtotal	87	2,600,786	29,894	2,436,498	28,006	123,254	5.1%	1,172,897	65,937	2.7%
Totals, Croatia Banka		198	3,034,468	15,326	2,603,789	13,150	155,783	6.0%	1,256,542	82,315	3.2%
Jadranska Banka											
Small Credits		192	1,005,113	5,235	705,336	3,674	129,274	18.3%	359,243	82,471	11.7%
SME		38	1,025,089	26,976	947,943	24,946	43,953	4.6%	473,972	0	0.0%
Totals, Jadranska Banka		230	2,030,202	8,827	1,653,279	7,188	173,227	10.5%	833,215	82,471	5.0%
Totals, All Banks		789	8,050,756	10,204	6,249,458	7,921	517,801	8.3%	3,151,354	330,469	5.3%
Total Small Crafts Loans		605	2,781,577	4,598	1,453,345	2,402	253,149	17.4%	735,768	unavailable	
Total SME Loans		184	5,269,183	28,637	4,796,113	26,066	264,652	5.5%	2,415,586	unavailable	
Total All Loans, All Banks		789	8,050,760	10,204	6,249,458	7,921	517,801	8.3%	3,151,354	330,469	5.3%